**The Causes of the Great Depression**

**1. False Sense of Prosperity Before The Great Depression**

The 1920s, known as “The Roaring Twenties” marked a time when America was overdependent on production, automobiles were the leading industry, and there was a great disparity between rich and poor. More than 60% of the population was living below poverty levels, while a mere 5% of the wealthiest people in America accounted for 33% of the income, and the richest 1% owned 40% of the nation’s wealth. This uneven distribution of wealth was mirrored in the unequal distribution of riches between industry and agriculture.

**2. Stock Market Crash of 1929**

Many believe erroneously that the stock market crash that occurred on [Black Tuesday](http://useconomy.about.com/od/glossary/g/Black_Tuesday.htm), October 29, 1929 is one and the same with the Great Depression. In fact, it was one of the major causes that led to the Great Depression. Two months after the original crash in October, stockholders had lost more than $40 billion dollars. Even though the stock market began to regain some of its losses, by the end of 1930, it just was not enough and America truly entered what is called the Great Depression.

**3. Speculation And Overleverage In The Great Depression**

With only loose stock market regulations in place before the Great Depression, investors were able speculate wildly, buying stocks on margin, needing only 10% of the price of a stock to be able to complete the purchase. Rampant speculation led to falsely high stock prices, and when the stock market began to tumble in the months leading up to the [October 1929 crash](http://thegreatdepressioncauses.com/stock-market.html), speculative investors couldn’t make their margin calls, and a massive sell-off began. While the great rise in the stock market (from 181 points in early 1928 to 381 points in September 1929) was fueled by optimism and false hope, the plunge was flamed by stark fear.

**4. Bank Failures**

Throughout the 1930s over 9,000 banks failed. Bank deposits were uninsured and thus as banks failed people simply lost their savings. Surviving banks, unsure of the economic situation and concerned for their own survival, stopped being as willing to create new loans. This exacerbated the situation leading to less and less expenditures.

**5. Overproduction**

Farmers in America enjoyed record crops and record profits in the first two decades of the 20th century. This was especially true during WWI as belligerent European powers looked to the American breadbasket for food. However, as the 1930's approached, farmers were suffering from depressed [prices](http://www.helium.com/items/486948-american-history-the-causes-of-the-great-depression) caused in part by overproduction and were paying more to grow their crops than they could get for their products on any market.

American industry was also overproducing. [Efficiency](http://www.helium.com/items/486948-american-history-the-causes-of-the-great-depression) experts, modern machinery, and improved methods led to increased productivity. The big problem was that more was being produced than could be sold. As inventories piled up, manufacturers had little choice but to cut jobs.

**6. Reduction in Purchasing Across the Board (Underconsumption)**

With the stock market crash and the fears of further economic woes, individuals from all classes stopped purchasing items. This then led to a reduction in the number of items produced and thus a reduction in the workforce. As people lost their jobs, they were unable to keep up with paying for items they had bought through installment plans and their items were repossessed. More and more inventory began to accumulate. The unemployment rate rose above 25% which meant, of course, even less spending to help alleviate the economic situation.

**7. American Economic Policy with Europe**

As businesses began failing, the government created the [Smoot-Hawley Tariff](http://americanhistory.about.com/od/greatdepression/f/smoot_hawley.htm) in 1930 to help protect American companies. This charged a high tax for imports thereby leading to less trade between America and foreign countries along with some economic retaliation.

**8. Ecological Conditions (The Dust Bowl)**

While not a direct cause of the Great Depression, the [drought](http://weather.about.com/od/drought/f/droughts.htm) that occurred in the Mississippi Valley in 1930 was of such proportions that many could not even pay their taxes or other debts and had to sell their farms for no profit to themselves. The area was nicknamed "[The Dust Bowl](http://useconomy.about.com/od/criticalssues/p/The_Dust_Bowl.htm)." This was the topic of John Steinbeck's *The Grapes of Wrath*.

**9. Reduction of the Money Supply**

One explanation that has stood the test of time focuses on the collapse of the U.S. banking system and resulting contraction of the nation’s money supply. Economists Milton Friedman and Anna Schwartz make a strong case that when there was less money available (i.e., because banks did not loan it or people hoarded it) it caused a sharp decline in prices. As the money supply fell, spending on goods and services declined, which in turn caused firms to cut prices and output and to lay off workers. The resulting decline in incomes made it harder for borrowers to repay loans. Defaults and bankruptcies soared, creating a vicious spiral in which more banks failed, the money supply contracted further, and output, prices and employment continued to decline.